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No. 06-1382

In the Supreme Court of the United States

RITA J. McCONVILLE,

Petitioner,

v.

THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

1. There Is A Circuit Split On An Important Question Of Federal Securities Law And This Case Is An Appropriate One Through Which To Resolve The Conflict.

This case squarely presents the question of whether, after this Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), the "bright line" test adopted by the Second, Sixth, Tenth, and Eleventh Circuits[1], or the "substantial participation" test followed in the Seventh and the Ninth Circuits[2] properly

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[1] *Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997)(defendants "must themselves make a false or misleading statement (or omission) that they knew or should know would reach potential investors"); *Wright v. Ernst & Young LLP*, 159 F.3d 169, 174-75 (2d Cir. 19989)("[a] defendant must actually make a false or misleading statement in order to be held liable under Section 10(b). Anything short of such conduct is merely aiding and abetting, and no matter how substantial that aid may be, it is not enough to trigger liability under Section 10(b)."); *Fidel v. Farley*, 392 F.3d 220 (6th Cir. 2004); *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215, 1226 (1996); *Ziemba v. Cascade International, Inc.*, 256 F.3d 1194 (11th Cir. 2001).

[2] *In re Software Toolworks, Inc.*, 50 F.3d 615, 628 n. 3 (9th Cir. 1994); *Howard v. Everex Systems, Inc.*, 228 F.3d 1057, 1061 n.5 (9th Cir. 2000)("substantial participation or intricate involvement in the preparation of fraudulent statements is grounds for primary liability even though that participation might not lead to the actor's actual making of the statements"); *McConville v. Securities and Exchange Commission*, 465 F.3d 780, 788 (7th Cir 2006)("substantial involvement in compiling the misleading

articulates the scope of conduct proscribed by SEC Rule 10b-5(b), 17 C.F.R. §240.10b-5 ("Rule 10b-5") and §10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b)("§10(b)").

Respondent ("SEC" or the "Commission"), held that Petitioner ("McConville") violated Rule 10b-5 and thereby §10(b) when her employer, Akorn, Inc. ("Akorn") filed a misleading Form 10-K with the Commission. McConville did not sign, file, or disseminate the Form 10-K or direct anyone else to do so. Thus, she did not make a false or misleading statement within the meaning of Rule 10b-5(b) as that Rule has been construed by the Second, Sixth, Tenth, and Eleventh Circuits. The Seventh Circuit, however, held that what it characterized as her "substantial involvement" in the compilation of the misleading statements[3] was sufficient to establish that she made a false statement or omission within the meaning of Rule 10b-5. Pet. App. B, 16a. The outcome of this case was thus plainly dependent upon which circuit court of appeals had jurisdiction over McConville's Petition to set aside the SEC's Order pursuant to 15 U.S.C. §78y.

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statements . . . is substantial evidence to establish that McConville made a false statement or omission.").

[3] The individual who compiled Akorn's financial statements and was responsible for preparing Akorn's Form 10-K, Thomas Costello (*see In re Thomas D. Costello,* SEC Release Case No. 48906, ¶¶9, 10), reported to McConville. She read a draft of the "core financial statements" ultimately included in the Form 10-K. She wrote one footnote for inclusion in the Form 10-K. She informed Akorn's auditors that, to the best of her knowledge, the financial statements they audited were accurate.

Despite widespread judicial[4] and academic[5] recognition of the circuit split on this important question of federal securities law,[6] the Commission argues against granting McConville's Petition on the grounds that no split exists. According to the Commission, McConville's (former) status as a corporate executive distinguishes this case from those decided by the Second, Sixth and Eleventh Circuits. The SEC contends, in essence, that §10(b) and Rule 10b-5 should be enforced one way against employees of issuers—persons whom the SEC labels as "corporate executives"—and another way against all

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[4] *See, e.g., Securities and Exchange Commission v. Lucent Technologies, Inc.*, 363 F.Supp.2d 708, 719 - 24 (D.N.J. 2005) (identifying and discussing the various decisions that had by then adopted the Second Circuit's "bright line" test or some close variant thereof or the Ninth Circuit's "substantial participation" test.

[5] *See, e.g.*, Mary W. Wynne, Primary Liability Amongst Secondary Actors: Why the Second Circuit's "Bright Line" Standard Should Prevail, 44 ST. LOUIS U. L. J. 1607, 1612 (2000); Note, Lifting the Fog: Finding a Clear Standard of Liability for Secondary Actors under Rule 10b-5, 41 VAL. U.L. REV. 403, 454 (2006).

[6] This Court has long recognized the importance of having uniform standards to determine the scope of conduct proscribed by Rule 10b-5 and §10(b). *Cf. Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 188-89 (1994) (recognizing that liability under the federal securities laws represents "an area that demands certainty and predictability" and warning that a "shifting and highly fact-oriented disposition" does not provide a "satisfactory basis for a rule of liability imposed on the conduct of business transactions" under §10(b) and Rule 10b-5) (quoting *Pinter v. Dahl*, 486 U.S. 622, 652 (1988) and *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 755 (1975)).

other persons—persons whom the SEC labels as "secondary actors." Once that distinction is recognized, the SEC argues, the Seventh Circuit's decision does not conflict with any decision of this Court or any other court of appeals. Brief for the Respondent in Opposition ("Comm'n Br."), 7 - 11. Secondarily, the SEC disputes the obvious connection between the issue presented in *Stoneridge Investment Partners, LLC v. Scientific-Atlanta, Inc.*, No. 06-43 - concerning the scope of conduct proscribed by Rule 10b-5(a) and (c) - and the question presented in this case - concerning the scope of conduct proscribed by Rule 10b-5(b).

The argument that §10(b) and Rule 10b-5 apply differently depending upon the status of the person accused of violating them has been made and rejected elsewhere. *See, e.g., Securities and Exchange Commission v. Lucent Technologies, Inc.*, 363 F.Supp.2d 708, 722 (D.N.J. 2005)(rejecting the SEC's argument that cases involving corporate executives should be distinguished from those where the "secondary actor" accused of violating §10(b) is a corporate outsider like an accountant or lawyer)[7]. More importantly, the SEC's proffered distinction finds no support in the texts of §10(b) or

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[7] On facts somewhat analogous to, but much more egregious than, those of this case, the district court applied the "bright line" test enunciated by the Second Circuit and held that an issuer's divisional CFO who personally drafted or assisted in drafting the critical document which caused the issuer's SEC filing to be false or misleading, knowing and intending that the document would have that consequence, but did not sign, file or disseminate the SEC filing could not have violated §10(b), although she could be held accountable pursuant to other provisions of the Exchange Act for aiding and abetting or causing the issuer's violation. *Lucent*, 363 F.Supp.2d at 719 - 724.

Rule 10b-5 or common sense, and the Commission cites no precedent recognizing such a distinction.

Both §10(b) and Rule 10b-5 state, in pertinent part, that "It shall be unlawful for *any* person . . . ." (emphasis supplied). Nothing in the additional texts of the statute and the Rule provides any basis to distinguish their applications based upon the status of "*any* person" as a corporate executive or a corporate outsider. As this Court observed in *Central Bank*, the text(s) of §10(b) (and Rule 10b-5) control decisions about the scope of conduct prohibited by the statute and the rule. *Central Bank*, 511 U.S. at 172.

Neither semantics nor common sense support an argument that a corporate executive cannot simultaneously be a "secondary actor." It is undisputed that McConville did not sign, file, or disseminate the Form 10-K. The Form 10-K did not attribute any of its contents to her. Akorn issued the Form 10-K. Akorn's officers and directors at the time of issuance signed the Form 10-K and filed or caused it to be filed with the Commission. Thus, Akorn and its officers and directors who signed the Form 10-K made statements when the Form 10-K was filed; McConville did not. McConville's involvement or participation in the preparation of the Form 10-K was no more substantial than, and consequently is qualitatively indistinguishable from that of the "secondary actors" whose conduct was at issue in the cases the Commission seeks to distinguish because the defendants were not "corporate executives". Since McConville did not make any statement when Akorn filed its Form 10-K, she was no more than a "secondary actor". Her culpability under §10(b) and Rule 10b-5 should be measured by the rules that apply to all other "secondary actors."

The Commission also argues that the cases holding that "secondary actors ... cannot be liable unless they themselves 'make' misstatements ... do not establish when, if at all, such secondary actors can be said to have 'made' misstatements issued by companies that they advise." Comm'n Br. p. 9. This argument approaches sophistry. A person cannot "make" a misstatement unless he or she states something.[8] McConville did not in any sense "state" the contents of Akorn's Form 10-K.

The Commission's argument that the issue in *Stoneridge Investment Partners* is disconnected from the issue presented here ignores the principle long ago recognized by this Court that Rule 10b-5 reaches no further than does §10(b). *See Central Bank*, 511 U.S. at 172-174. The statute, unlike the Rule, does not distinguish between types of "deceptive devices or contrivances." Thus, in order to decide the scope of conduct proscribed by Rule 10b-5(a) or (c) in *Stoneridge Investment*,[9] the Court will inevitably need to consider how its

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[8] The Oxford English Dictionary explains that "to make a statement" is equivalent to "to state." *Id.* Vol. IX, p. 247 (2d Ed.). Under the SEC's argument that "to make a statement" means to compile the statement, preparers of rough drafts of a Form 10-K never filed (because the draft contained a misstatement) but circulated for review using the jurisdictional means could violate §10(b), but a corporate officer who signs, files and disseminates a Form 10-K compiled by a subordinate and known to contain a misleading statement would not have thereby made a false or misleading statement.

[9] In *Stoneridge Investment* the Government argues that the outcome should turn on Petitioner's failure to allege and inability to prove reliance on Respondents' alleged misconduct. *Stoneridge Investment*, Brief for the United States As Amicus Curiae

decision will affect the analysis of what conduct is proscribed by Rule 10b-5(b). Granting the Petition in this case will enable that evaluation to proceed in the context of actual, rather than hypothetical, facts.

2. The Commission's Brief Demonstrates That This Case Is A Proper Case For The Court To Exercise Its Supervisory Authority.

As explained in the Petition (pp. 17-28), the Seventh Circuit utterly failed to provide McConville with the quality of review to which she was entitled under §25 of the Securities Exchange Act, 15 U.S.C. §78y. The Commission makes no serious effort to refute this point. It does not argue, e.g., that McConville did not actually raise with the Seventh Circuit any of the Commission's errors identified in the Petition as unaddressed by the Seventh Circuit. Nor does the Commission suggest the Seventh Circuit actually considered any of those issues, much less identify any relevant parts of that court's opinion showing that it did so. The Commission does not identify any substantial evidence in the record supporting the findings McConville challenged as unsupported by substantial evidence. The Commission does not cite even a single precedent supporting its construction of the statutes

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Supporting Affirmance, 9, 17-30 (2007) (No. 06-43). If so, that case will resolve on a question involving the elements of the Rule 10b-5 private liability scheme rather than the question presented for review, which concerns the scope of conduct prohibited by Section 10(b). *See Central Banks*, 511 U.S. at 172. Because the question in this case involving the scope of conduct proscribed by Section 10(b) is presented in the context of an SEC enforcement action, there is no risk that resolution of the question might need to be deferred for similar reasons. Reliance is not an element the Commission needed to prove in this case.

and rules (other than §10(b) and Rule 10b-5) McConville identified as having been incorrectly construed and applied by the Commission.

The Commission does mischaracterize its own Opinion in an effort to dissuade the Court from exercising its supervisory authority.[10] Consistent with that tactic, the Commission devotes much space to making it clear that if this Court does exercise its supervisory authority and grant McConville's Petition as to all of the questions presented, it will have to deal with a series of "fact-bound" issues. But that, unfortunately, is almost inevitable whenever a court of

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[10] For example, to persuade this Court that the Commission's findings conformed to the charges made in its Order Instituting Proceedings ("OIP"), the Commission's Brief states "the Commission also found that the Form 10-K misrepresented Akorn's net income, see Pet. App. 42a, and that finding alone would serve as a sufficient basis for sustaining the Commission's ultimate finding of a violation." Comm'n Br. at p. 12. Neither the word "income" nor any synonym of that word, such as profit, even appears on the cited page or elsewhere in that section of the Commission's Opinion. This is not a case of a typographical error. The supposed and "cited" finding is nowhere to be found in the Commission's Opinion. Rather, as McConville's Petition correctly points out (Pet. pp. 19-20), the Commission concluded (in the very section of its Opinion cited in the Commission's Brief) that Akorn's Form 10-K was misleading because "impairment [of Akorn's accounts receivable] should have been indicated" (Pet. App. 45a) even though the OIP made no such charge. (The OIP alleged that "Had Akorn appropriately recorded a reserve for its doubtful accounts, it would have posted a $2 million loss for its fiscal year ended December 31, 2000, rather than the $2 million profit it claimed in its 2000 Form 10-K." Pet. App. 72a). The Commission's Statement of the Case contains a number of similar inaccuracies.

appeals so far departs from the accepted and usual course of proceedings to review an administrative decision that the exercise of this Court's supervisory power is required.

Since the Seventh Circuit did not provide McConville with the type and quality of judicial review to which she is entitled pursuant to §25 of the Securities Exchange Act (and as a matter of fundamental due process), she has no remedy other than to seek such a review from this Court. It is appropriate for the Court to conduct such a review in this case because the case otherwise presents an issue independently warranting this Court's review.

The Court should grant the Petition on all issues presented, and issue its writ of certiorari to the United States Court of Appeals for the Seventh Circuit.

Respectfully submitted,

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